

NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION

1775 Duke Street, Alexandria, VA 22314

DATE: January 2011

LETTER NO.: 11-CU-01

TO: Federally Insured Credit Unions

SUBJ: Residential Mortgage Foreclosure Concerns

Dear Board of Directors:

I am writing this letter to alert you to key problems identified in the mortgage industry related to foreclosures – and to **urge you to perform an in-depth review of your mortgage documentation and foreclosure management processes.**

In recent months, questions have arisen regarding the adequacy and legality of some residential mortgage foreclosures. Several large mortgage lenders temporarily suspended their processing of foreclosures because of documentation deficiencies and concerns that their foreclosure actions were flawed or may not comply with applicable state laws governing foreclosures.

While foreclosures reported by credit unions represent only a small percentage of foreclosures nationwide, recent developments disclosed certain issues that may impact some credit unions:

- Mortgage Electronic Registration System (MERS) challenges;
- Missing or defective loan documents;
- Documentation deficiencies related to “Robo-signing;” and
- Contractual buy-back risks with serviced mortgages.

This letter identifies the main foreclosure issues, outlines appropriate practices to effectively manage foreclosures, and communicates future NCUA actions relative to these issues.

Mortgage Electronic Registration System (MERS) Challenges

The Mortgage Electronic Registration System (MERS) is an electronic loan registration system designed to track the servicing rights and ownership of mortgages in the secondary market. It was established by some of the largest mortgage lenders in the United States to streamline the mortgage securitization process and facilitate a faster and lower-cost transfer of ownership of securitized mortgages. **All loans sold by a credit union to Fannie Mae or Freddie Mac were likely registered or transferred through MERS.**

Under the MERS process, county land records typically list MERS as the record owner of the mortgage but the MERS internal systems reflect the current beneficial owner and servicer. As loans are sold, the mortgage continues to be recorded in MERS' name in county land records but MERS updates its internal systems to reflect the new beneficial owner and servicer. This allows mortgage loans to transfer unencumbered between servicers.

The first concern relating to the MERS process is whether MERS, as record owner of the mortgage, has the legal standing to initiate foreclosure in its own name. Recent court cases have challenged MERS' standing, or brought MERS' standing into question. **In states holding this opinion, this issue may be resolved by MERS reassigning the mortgage to the credit union.**

The second concern is whether MERS reassigning its interest in the mortgage to the lender holding the note allows the lender to legally initiate foreclosure on its own. There is question whether listing MERS as the mortgage owner of record irrevocably splits the mortgage and note preventing anyone from legally foreclosing on the property. No courts to date have ruled that it is split.

Credit unions using MERS need to obtain proper legal counsel if they encounter any of these issues.

Missing and Defective Loan Documents

As a result of the increase in residential mortgage loan activity over the last decade and a strong securitization market, some lenders failed to properly document and record mortgages. Fatal documentation flaws can prevent a mortgagee from foreclosing on the property and may result in an unenforceable claim. Flawed documentation, missing notes, and improper assignments of other necessary legal documents have also led to allegations of inappropriate action.

MERS, along with other lenders and mortgage servicers, relied on missing document affidavits to allow a foreclosure to proceed quickly, thus limiting homeowners' rights to due process under law. While this issue may delay the foreclosure process, absent evidence of fraud, most documentation flaws can likely be resolved.

Robo-Signing

Robo-signing is the practice of executing foreclosure affidavits without verifying whether the information supporting the foreclosure is accurate. Overwhelmed by the volume of foreclosure actions, personnel or agents of many of the largest lenders and mortgage servicers were found to be executing flawed or untrue affidavits to speed the foreclosure process. This led to:

- Lenders and servicers temporarily suspending foreclosure actions, until internal reviews were completed; and
- MERS establishing stricter standards and suspending members who were using robo-signers until their personnel were trained and tested.

While this issue may delay the foreclosure process, absent evidence of fraud, the documentation flaws can likely be resolved if facts supporting foreclosure exist.

Contractual Put-Back Risks

Another concern relates to the practice of requiring the originating lender to repurchase a mortgage sold on the secondary market. Commonly referred to as “put-backs,” an investor or purchaser of a mortgage can by contract require the lending institution, such as a credit union, to repurchase the mortgage at face value if the loan did not conform to representations and warranties about the loan quality or documentation. Examples can include misrepresentations on the loan application or underwriting that did not conform to stated standards.

It is unclear if this represents a material risk; however, in light of market conditions, many investors are considering this a useful tool to mitigate risk of loss. **A significant put-back requirement could materially impact a credit union’s net worth, earnings and liquidity.**

Credit Union Due Diligence

NCUA anticipates the foreclosure issues discussed above will have limited impact on most credit unions. However, in credit unions that use MERS or have sold residential mortgage loans in the secondary market, management needs to evaluate the impact that recent residential mortgage foreclosure developments may have on the credit union and its members.

In addition, NCUA has long held that every credit union should exercise appropriate due diligence in managing the risks associated with each area of credit union operations. **It is imperative that the board of directors and management of every credit union review the credit union’s foreclosure process to ensure that the following elements are in place:**

- **Appropriate policies and procedures** for all aspects of the foreclosure process, tailored to comply with the laws of each state the credit union does business in;
- **Experienced and knowledgeable staff** qualified to handle foreclosures;
- **Effective internal controls** surrounding the foreclosure process;
- **Adequate oversight, due diligence, and control of third-party servicers** performing foreclosures on behalf of the credit union;¹
- **Legally compliant documentation** to support foreclosure actions; and
- **Appropriate reporting to the board of directors** of the number and volume of foreclosure actions and their financial impact on the credit union.

Furthermore, **NCUA continues to strongly encourage credit unions to work with delinquent residential mortgage borrowers by modifying the terms of their loans if modification is determined to be less costly than foreclosure.**² Therefore, for each foreclosure action, there should be a documented evaluation of the feasibility of a loan modification prior to proceeding with foreclosure.

Credit unions should also suspend foreclosure actions during modification negotiations and during the temporary modification period whenever legally possible. This process known as “dual tracking” causes unnecessary confusion and anxiety for distressed borrowers and can result in unnecessary and costly errors.

NCUA Actions

NCUA is expanding examination procedures in 2011 to include an in-depth review of foreclosure practices in credit unions involved in residential mortgage lending. In addition to assessing the safety and soundness of the credit union’s foreclosure processes and the level of risk associated with those processes, examiners will evaluate the extent to which credit union management has sought alternatives to foreclosure.

¹ Letter to Credit Unions 07-CU-13, Evaluating Third Party Relationships, provides credit unions guidance on a comprehensive, effective, and ongoing vendor due diligence program. <http://www.ncua.gov/letters/2007/CU/07-CU-13.pdf>

² See NCUA Letter to Credit Unions 09-CU-19 (September 2009), Evaluating Residential Real Estate Mortgage Loan Modification Programs, at <http://www.ncua.gov/Resources/RegulationsOpinionsLaws/OpinionLetters/2009/09-CU-19.pdf>

Examination procedures for foreclosures will be standardized through the use of a questionnaire scheduled for release in March. Future examination procedures for foreclosures will specifically emphasize appropriate due diligence on vendors, quality control reviews on foreclosure processes, and stress event analysis and reporting.

If you have any questions related to this letter, please contact your NCUA regional office, district examiner, or state supervisory authority.

Sincerely,

/s/

Debbie Matz
Chairman